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[January 4, 1926.]

Mr. Justice STONE delivered the opinion of the Court.

The appellees in both cases brought suit in the Court of Claims to recover payments of corporate income taxes alleged to have been erroneously exacted. From judgments in their favor the Government brings the cases to this court on appeal. Jud. Code, § 242, before amendment of 1925.

For the purpose of discussing the main question raised by both appeals, No. 420 will first be considered, and such additional questions as are involved in No. 337 will then be taken up.

The appellee, Yale & Towne Manufacturing Co., a Connecticut corporation, was, in 1916, engaged in the manufacture of munitions. The tax imposed by the United States on the profits on munitions manufactured by it and sold during that year, became due and was paid in 1917. In making its return for income tax for the year 1917, the appellee deducted from its gross income the amount of the munitions tax thus paid. Later the Commissioner of Internal Revenue held that the munitions tax paid in 1917 should have been deducted from the appellee's gross income in its return for 1916. There was in consequence an adjustment of the income taxes payable in those years, resulting in a net increase of the tax payable for the year 1917 of \$116,044.40, which was

assessed and paid under protest and is the amount for which suit was brought.

The correctness of the determination of the Commissioner depends upon the construction of the Revenue Act of 1916 and its application to the particular method employed by the taxpayer in keeping its books of account and in making return for income tax for 1916. The pertinent provisions of the statute are sections 10, 12(a), 13(a) and (d) and 300 of the Revenue Act of 1916 (c. 463, 39 Stat. 756, 765, 767-8, 770-1, 780-1). The Act imposes a tax on net income and profits ascertained as provided by § 12(a), by deducting from gross income, expenses paid, losses sustained, interest and taxes paid during the calendar year. Section 13(d) however, provides that:

“a corporation . . . keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as returned . . .”

In the year 1916 the appellee set up on its books of account all the obligations or expenses incurred during the year whether they fell due and whether they were paid during that year. It entered in an account, “reserves for taxes”, items of various kinds of taxes, liability for which was incurred by reason of its operations for that year, whether paid or payable during the year. Included in the reserves for taxes for 1916 were items aggregating \$247,763.19 for taxes on profits from the sale of munitions during the year. The return for the munitions tax was made by the appellee in 1917, and the tax, after revision and an additional assessment, was paid in 1917, the year when it was due.

In making up its income tax return for 1916, appellee deducted from gross income all the items appearing on its books as losses sustained and obligations and expenses incurred during the year, except that it omitted from the return the items of munitions tax, likewise carried on its books, as an obligation or expense incurred or accrued in the year.

It is urged by the Government that the appellee, not having kept its books or made its tax return on the basis of receipts and disbursements, has elected to avail itself of the privilege afforded by

§ 13(d) of making its return on what was referred to in the briefs and argument as "the accrual basis"; that having so elected, it is required consistently to deduct from gross income all items appearing on its books as expenses accruing or incurred during the taxable year, including its reserve for munitions taxes, whether payable or not.

It is not denied by the appellee that its method of keeping its accounts and setting up a reserve for munitions taxes reflected its true income for 1916 or that its amended return on that basis accurately reflects its income and profits for the year. But it contends that the munitions tax was deductible only in 1917 because under the Revenue Act of 1916 only taxes actually paid during the year were deductible in determining net income for the year; and that in any case the provisions of that Act and the regulations made by the Commissioner, authorizing the taxpayer to make his returns on an "accrual" basis if his books are so kept, could have no application to tax deductions, since a tax does not accrue until it is due and payable.

While § 12(a) taken by itself would appear to require the income tax return to be made on the basis of actual receipts and disbursements, it is to be read with § 13(d) which we have quoted and which obviously limits in some respects the operation of § 12(a) by providing in substance that a corporation keeping its books on a basis other than receipts and disbursements, may make its return on that basis provided it is one which reflects income.

Standing by themselves and taken at their face value, these sections would seem to require the taxpayer to make his return on the basis of receipts and disbursements or, in the alternative, on the basis of its own books of account if they reflect true income, under such regulations as the Commissioner may make, and indeed to require the latter alternative if the taxpayer is unable to make his return on that basis.

So interpreting the statute, the Commissioner, with the approval of the Secretary of the Treasury, on January 8, 1917, before appellee made its income tax return for 1916, promulgated Treasury Decision 2433 which provides in part that under § 13(d) it

"will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as

nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis."

It also provided in substance that when the taxpayer, following a consistent accounting practice, sets up reserves to meet liabilities, the "amount of which or date of maturity" is not definitely determinable, such reserve may be deducted from gross income. The decision also laid down a procedure for readjusting such reserves when the amount actually required for that purpose was definitely ascertained, and provided that if returns upon this basis of "accrual or reserves" did not reflect true net income, the taxpayer would not be permitted to make its return on any other basis than that of "actual receipts and disbursements."

We think that the statute was correctly interpreted by the Commissioner and that his decision referred to was consistent with its purpose and intent.

The Revenue Acts of 1909 and 1913 authorized a method of computing the income of corporations, which did not differ materially from that provided by § 12(a) of the Act of 1916. They required in terms that net income should be ascertained by deducting from gross income received, interest, expenses and taxes actually paid and losses actually sustained, but contained no provision corresponding to § 13(d) of the Act of 1916 by which a return might be made on the basis of the taxpayer's books of account. Corporation Excise Tax, Act of August 5, 1909, c. 6, § 38, 36 Stat. 11, 112; Corporation Income Tax, Act of October 3, 1913, c. 16, Section II, subdiv. G, 38 Stat. 114, 172.

It was pressed upon us in argument by appellees that it was found impracticable to comply strictly with the requirements of the 1909 and 1913 Acts for computing income on the basis of receipts and disbursements and that under both acts the administrative practice was established, by appropriate Treasury regulations, permitting the use of inventories and authorizing deduction of expenses constituting a liability of the taxpayer, whether paid or not, in ascertaining net income, but that those regulations did not permit the deduction of taxes except in the year when paid. From this it is argued that Congress, by re-enacting in § 12(a) of the Act of 1916 the corresponding provisions of the earlier acts,

adopted the settled administrative practice, and that accordingly under that act, as well as under the earlier acts and Treasury regulations, taxes could be deducted only in the year when paid.

This argument would have force had Congress stopped with the enactment of § 12(a). By thus adopting, without material change, the corresponding provisions of earlier acts, Congress might have been deemed to have recognized and adopted the established practice of the Department interpreting and applying them. *National Lead Co. v. United States*, 252 U. S. 140. But, in the Act of 1916, Congress added § 13(d), which did not have its counterpart in earlier legislation. This section went further than any previous regulation by authorizing the tax return to be made on the basis on which the taxpayer's books were kept, provided only that the basis was one reflecting income and the return complied with regulations made by the Commissioner.

Treasury Decision 2433, to which reference has been made, was in harmony with this view of § 13(d). It recognized the right of the corporation to deduct all accruals and reserves, without distinction, made on its books to meet liabilities, provided the return included income accrued and, as made, reflected true net income. If the return failed so to reflect income, the regulation reserved the right of the Commissioner to require the return to be made on the basis of receipts and disbursements.

A consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements for a business of any complexity, which had been experienced in the application of the Acts of 1909 and 1913 and which made it necessary to authorize by departmental regulation, a method of preparing returns not in terms provided for by those statutes, indicates with no uncertainty the purpose of §§ 12(a) and 13(d) of the Act of 1916. It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.

The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the

year the total cost and expenses attributable to the production of that income during the year. The reserve for munitions taxes set up on its books for 1916 must have been deducted from receivables for munitions sold in that year before the net results of the operations for the year could be ascertained. The taxpayer being unable to make its return on a strict receipts and disbursements basis, and not having attempted to do so, could not have complied with § 13(d) and Treasury Decision 2433 by deducting either accruals of interest or expenses alone without the other, or without deducting other reserves made on its books to meet liabilities such as the munitions tax, incurred in the process of creating income.

Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued. It should be noted that § 13(d) makes no use of the words "accrue" or "accrual" but merely provides for a return upon the basis upon which the taxpayer's accounts are kept, if it reflects income—which is precisely the return insisted upon by the Government. We do not think that the Treasury decision contemplated a return on any other basis when it used the terms "accrued" and "accrual" and provided for the deduction by the taxpayer of items "accrued on their books".

United States v. Woodward, 256 U. S. 632, relied upon by appellees, arose under the Income Tax Law of 1918, (c. 18, Title II, §§ 210-214, 219, 1405, 40 Stat. 1062-1067, 1071, 1151). Section 213(a) and (e) of that Act provided that taxes "paid or accrued" within the taxable year imposed by authority of the United States, except income, war profits and excess profits taxes, might be deducted in ascertaining income. The claim of the taxpayer of the right to deduct estate taxes levied under that Act for the year

when due, although paid in a later year, was upheld. It did not appear whether, as here, the taxpayer kept his books on the accrual basis or whether, as here, events had occurred before the tax became due which fixed the amount of it; for it did not appear whether the deductions to be made from the testator's gross estate were ascertainable for the purpose of determining the estate tax. The question which we now have to determine was not raised, considered or decided in that case.

We conclude that the reserves for taxes which appeared on appellee's books in 1916 were deductible under § 13(d) of the Act of 1916 and Treasury Decision 2433 in its income tax return on the accrual basis for that year.

It was argued in behalf of the appellees in No. 337 that the taxpayer did not keep its books on an accrual basis; that consequently its case was not controlled by § 13(d) and Treasury regulations made under it, and that by § 12(a) it was authorized to deduct the amount assessed for munitions taxes only in 1917, the year when paid. On this point we are concluded by the findings. They show that in the year 1916 the taxpayer accrued on its books expenses, whether paid or not, including "insurance reserves," "freight reserves", "bonus reserves," and depreciation charged off, aggregating more than two and a half million dollars, which it deducted from accrued gross income, whether actually received or not, in making its income tax return for the year. It charged on its books and deducted in its income tax return, interest accrued and paid during the year. So far as appears no other interest accrued during the year and there was no reserve for interest. No charge or deduction was made for bad debts. It also set up on its books for that year a monthly reserve of \$35,000 for the payment of munitions taxes beginning with September, the month of the passage of the Revenue Act of 1916 taxing munitions. On December 31, 1916, this reserve account was closed out and a charge was made on its books against the corporate surplus for account of munitions taxes of \$86,541.95. No deduction was made by the taxpayer for munitions taxes in its income tax return for the year 1916. In 1917 the munitions tax was returned and ultimately assessed and paid in the sum of \$112,419.54.

Since the suit was one to recover a tax erroneously exacted, the burden was on the petitioners, appellees here, to prove the facts establishing the invalidity of the tax. But the findings fail to show

affirmatively that the books were kept or the return made on the basis of receipts and disbursements. Indeed, the facts found, to which we have referred, show that the books were kept on the basis of accruals and reserves to meet liabilities incurred. It does not appear that there was any expense or liability of the taxpayer incurred by its operations during the year which was not accrued on its books. Its return was made on that basis, but omitted munitions taxes accrued on its books during the year for which the return was made. We think these facts bring the case clearly within the principle which we deem to be applicable to No. 420. The judgment of the Court of Claims in each case is

Reversed.

Mr. Justice SUTHERLAND and Mr. Justice SANFORD dissent.

A true copy.

Test:

Clerk, Supreme Court, U. S.